

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter' of the Appeal of }
INDEPENDENT ROCK CO., LTD. }

Appearances:

For Appellant: W. L. Engelhardt, Attorney; M. A. Egan,
Secretary for Appellant
For Respondent: Chas. J. McColgan, Franchise Tax Commissioner

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Independent Rock Co. Ltd., a corporation, against his proposed assessment of an additional tax of \$420.02 for the year 1931 based upon its net income for the year ended December 31, 1931.

It appears that the Appellant., Independent Rock Co. Ltd., a California corporation, and Du Cal Company Ltd., also a California corporation, are affiliated corporations within the meaning of Section 14 of the Act. The Appellant commenced to do business in this State for the first time during the year 1931. Apparently the Du Cal Company Ltd., had been engaged in business in this State for sometime prior to 1931.

For the year 1931 the Appellant realized a profit of \$11,125.56, whereas Du Cal Company Ltd. sustained a loss for the year 1931 of \$14,804.99. Within two months and fifteen days after the close of the year 1931, the Appellant and the Du Cal Company Ltd. filed a consolidated return upon the basis of which the Appellant contends its tax for the year 1931 should be computed. If the Appellant is correct in this contention, an additional assessment should not have been proposed by the Commissioner inasmuch as the consolidated return disclosed no net income for the year 1931, but in fact showed a loss. But if Appellant's tax for the year 1931 should be computed on the basis of its net income for that year rather than on the basis of the consolidated return of the two affiliated corporations, then the Commissioner must be considered as having acted properly in proposing the additional assessment in question,

Section 13 of the Act provides, insofar as it is relevant, : "that

"...a corporation which commences to do business in this state, after the effective date of this act, shall there- upon prepay the minimum tax hereunder, and upon filing

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of its return within two months and fifteen days after the close of its taxable year its tax for that year shall be adjusted upon the basis of the net income received during that taxable year. Said return shall also, in accordance with sections 23 to 26 inclusive, be the basis for the tax of said bank or corporation for its second taxable year..."

But Section 14 provides that

"...an affiliated group of corporations shall; subject to the provisions of this section, have the privilege of making a consolidated return for any taxable year in lieu of separate returns."

There is no question but that Appellant commenced to do business in this State for the first time after the effective date of the Act during the year 1931 and that its tax for its first taxable year should be computed in accordance with the above quoted provisions of Section 13 were it not for the fact that it was affiliated with Du Cal Company, Ltd., and were it not for the provisions of Section 14 of the Act relating to consolidated returns.

Unquestionably, it seems that Section 14 extends to affiliated corporations, without exception, the privilege of filing a consolidated return in lieu of separate returns. Hence, it would seem that the Appellant and the Du Cal Company, Ltd., were entitled to file a consolidated return for the year 1931, instead of each filing a separate return for that year. But it does not follow that Appellant's tax for its first taxable year should be computed on the basis of the consolidated return. It is to be noted that Section 14, although it permits the filing of consolidated returns, does not in express terms provide for the computation of a tax on the basis of the consolidated return. However, it is reasonable to conclude that it was intended that where a consolidated return is filed, for one year, then the taxes for the succeeding year of the affiliated group should be computed on the basis of the consolidated return, for otherwise it would be idle to permit the filing of consolidated returns. This conclusion is supported by the following provision of Section 26:

Where a consolidated return has been made under section 14 hereof the offset allowable against the tax liability of the consolidated group may include said property taxes paid during said period by all corporations which are included in the consolidated group..."

But there is absolutely no justification for concluding that the consolidated return should be used as a basis for computing the tax liability of all the members of the affiliated group for the succeeding year and also be used as the basis for computing a tax upon one of the members of the affiliated group for the year for which the return was filed,

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Hence, we conclude that where an affiliated group elects to file a consolidated return for a particular year in lieu of separate returns, the consolidated return should be used as a basis for computing the tax liability of the affiliated group for the succeeding year, but where one of the members of the affiliated group has commenced to do business in this State, for the first time after the effective date of the Act, during the year for which the consolidated return is filed, we must look to other sections of the Act to determine how the tax liability of that member for its first taxable year should be computed. The only section of the Act which relates to the computation of the tax for the first taxable year of a corporation is Section 13, the relevant provisions of which were quoted above. That section provides in unequivocal terms that where a corporation commences to do business in this State for the first time after the effective date of the Act, its tax for the year in which it commences to do business shall be adjusted upon the basis of the net income received during that year.

It is true that Section 13 considered alone is not applicable to a member of an affiliated group that has elected to file a consolidated return in lieu of separate returns but is applicable only to corporations that file separate returns. However, we believe that Section 13 should not be considered alone but should be construed together with Section 14. Section 14 relieves affiliated corporations from the obligation of filing separate returns. But there is nothing in Section 14 which relieves a corporation commencing to do business in this State for the first time after the effective date of the Act from that part of Section 13 which provides that its tax for the year in which it commences to do business shall be adjusted upon the basis of its net income received during that year.

Consequently, we must conclude that the Commissioner acted properly in computing Appellant's tax for the year 1931, the year in which Appellant commenced to do business in this State, upon the basis of its net income received during that year rather than upon the basis of the consolidated return of the Appellant and its affiliate, the Du Cal Company, Ltd.

O R D E R

Pursuant to the views expressed in the opinion of the Board of Equalization on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Honorable Chas. J. McCollgan, Franchise-Tax Commissioner, in overruling the protest of Independent Rock Co., Ltd., against proposed assessment of additional taxes under Chapter 13, Statutes of 1929 as amended, based upon the returns of the above company for the taxable year ended December 31, 1931, be and the same is hereby sustained.

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Done at Sacramento, California, this 10th day of October,
1932.

R. E. Collins, Chairman
Fred E. Stewart, Member
Jno. C. Corbett, Member
H. G. Cattell, Member

ATTEST: Dixwell L. Fierce, Secretary